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SIPDIS

TREASURY FOR TRACI PHILLIPS

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SUBJECT: SPANISH BUDGET VETOED IN THE SENATE AS EXPECTED

REF: MADRID 4385

1. Summary. Spain's Senate vetoed December 13 the Socialist government's 2005 budget. The budget, which already passed the lower house, will now be returned for further consideration. The lower house may pass the budget over the Senate's objections next week by an absolute majority, or by a simple majority in two months time. This act marks the first time Spain's Senate has returned a budget to the lower house. End Summary.

2. The Popular Party and three nationalist parties joined forces to reject the government's budget December 13 with a vote of 140-117. The budget will now return to the lower house for reconsideration for the first time in Spanish history. The lower house will review the budget next week. The minority Socialist government can pass the budget over the Senate's objection if it can maintain the absolute majority it had on the first reading of the budget in the lower house. If the lower house fails to pass the budget next week, it can be passed by a simple majority in February. The government would continue to operate in January and February based on one-twelfth of 2004 budget numbers each month.

3. The Socialist government negotiated an absolute majority in the lower house where it holds the largest number of seats. It received the support of the Republican Left of Catalonia (ERC) and the communist United Left (IU) when the budget passed the lower house.

4. The Socialist government faced a different situation in the Senate, where the opposition Popular Party (PP) holds the most seats. In order for the government to pass a law in the Senate, it requires the support of all non-PP parties. Minister of Economy and Finance Pedro Solbes opposed additional negotiations with regional parties in the Senate that were not allies in the budget passage in the lower house. The opposition PP joined with Catalonia's Convergence and Union, the Galician National Party, the Basque Nationalist Party, the Canary Coalition and the Mixed Party Senator to embarrass the government with the veto. The PP economic spokesperson in Parliament offered no substantive objections to the budget, but commented that the Senate's veto shows this government's weakness. A contact in the Ministry of Economy rejected that analysis, noting that Solbes stuck to his spending limits, and by not negotiating a face-saving deal with regional parties in the Senate, proved that he is a strict budgetary guardian.

4. Comment. The historic veto of the Socialist government's first budget may amount to little more than parliamentary bickering and the opposition's attempt to embarrass its political rival. Contacts at the Ministry of Economy and Finance predict that the government will have the votes to pass the budget next week over the Senate's objections. The important message coming out of the Spanish budget debate is that Minister of Economy and Finance Pedro Solbes has the will to maintain budgetary spending limits. Solbes preferred that the Socialists accept the embarrassment of a Senate veto to meeting additional budgetary demands of regional parties. This budget year, the Socialists will be able to maintain the support of their alliance with ERC and IU in the lower house to pursue a conservative fiscal policy. The question is whether Solbes and the Socialist government will be able to maintain this alliance in the coming years under less rosy economic conditions.

MANZANARES